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In The
Supreme Court of the United States

HARRISON CENTRAL APPRAISAL DISTRICT,

Petitioner,

v.

THE PEOPLES GAS, LIGHT AND COKE COMPANY,

Respondent.

On Petition For A Writ Of Certiorari To The Texas Court Of Appeals, Sixth Appellate District

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the dormant Commerce Clause prohibits a State from imposing a generally applicable, nondiscriminatory ad valorem tax on natural gas stored in the State but connected to an interstate pipeline system for out-of-state transport.

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PETITION FOR A WRIT OF CERTIORARI

The Texas court of appeals held a generally applicable, nondiscriminatory state ad valorem tax to be unconstitutional, as applied to natural gas in storage on an interstate pipeline system. App., *infra*, 22. On virtually identical facts the Supreme Court of Oklahoma, "unpersuaded by [the Texas] court's reasoning," held such a tax to be constitutional. *In re Assessment of Personal Prop. Taxes Against Mo. Gas Energy*, 234 P.3d 938, 959 n.84 (Okla. 2008), *cert. denied*, 130 S. Ct. 1685 (2010). Before denying certiorari in *Missouri Gas*, this Court invited the Solicitor General to express the views of the United States. The Solicitor General advised the Court that the Oklahoma Supreme Court had reached the right result on the constitutional merits and the conflicting decision of the Texas court was therefore wrong:

> The Oklahoma Supreme Court correctly held that, under this Court's modern dormant Commerce Clause jurisprudence, petitioner had failed to establish the unconstitutionality of applying the State's ad valorem tax on personal property to stored natural gas.

Br. for U.S. (No. 08-1458), at 9.

Now that the Texas court's decision is final, this Court should grant certiorari, resolve the conflict between the decision below and the decision of the Supreme Court of Oklahoma, and reach the same conclusion on the merits that the Solicitor General did in *Missouri Gas*.

OPINIONS BELOW

The opinion of the state court of appeals (App., *infra*, 1-22) is reported at *Peoples Gas, Light, and Coke Co. v. Harrison Cent. Appraisal Dist.*, 270 S.W.3d 208 (Tex. App. – Texarkana 2008, pet. denied). The state trial court issued findings of fact and conclusions of law (App., *infra*, 25-45), which are unreported.

JURISDICTION

The judgment of the Texas Sixth District Court of Appeals (App., *infra*, 23-24) was entered on September 24, 2008. The Supreme Court of Texas denied review of that judgment on March 12, 2010 (App., *infra*, 48), and denied rehearing on October 1, 2010 (App., *infra*, 49). The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause provides: "The Congress shall have power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const., Art. I, § 8, cl. 3.

Section 11.01 of the Texas Tax Code provides:

> (a) All real and tangible personal property that this state has jurisdiction to tax is taxable unless exempt by law.
>
> (b) This state has jurisdiction to tax real property if located in this state.
>
> (c) This state has jurisdiction to tax tangible personal property if the property is:
>
> > (1) located in this state for longer than a temporary period;
> >
> > (2) temporarily located outside this state and the owner resides in this state; or
> >
> > (3) used continually, whether regularly or irregularly, in this state.
>
> (d) Tangible personal property that is operated or located exclusively outside this state during the year preceding the tax year and on January 1 of the tax year is not taxable in this state.

Tex. Tax Code § 11.01.

STATEMENT

Like the *Missouri Gas* case, "[t]his case involves a State's taxation of natural gas stored in underground facilities located in the State and connected to a pipeline system for interstate transport." Br. for U.S.

(No. 08-1458), at 1. The narrow constitutional question presented in both cases is the same: whether the dormant Commerce Clause prohibits a State from imposing a generally applicable, nondiscriminatory ad valorem tax on natural gas stored in the State but connected to an interstate pipeline system for out-of-state transport.

There is no material difference between this case and *Missouri Gas*. Yet the Texas and Oklahoma courts employed differing analyses and therefore reached conflicting results in resolving the same constitutional question. The explanation for this confusion is that gaps remain in this Court's modern dormant Commerce Clause jurisprudence. This case affords the Court the opportunity to resolve the direct conflict between Texas and Oklahoma, and also address a broader set of continuing constitutional controversies that are of immense practical and jurisprudential importance.

A. Factual Background

The Solicitor General recited the underlying facts of the *Missouri Gas* case in her invited amicus brief. *See* Br. for U.S. (No. 08-1458), at 1-4. Those facts are materially indistinguishable from the facts of this case.

Respondent The Peoples Gas, Light and Coke Company (Peoples) is a natural gas distribution company that purchases gas from shippers on a FERC-regulated interstate natural gas pipeline

system operated by Natural Gas Pipeline Company of America (Pipeline).[1] RR 2:63, 66-67, 69, 77. Peoples ultimately sells the gas to consumers in Chicago. RR 2:63.

As part of its system, Pipeline operates a large underground storage facility in North Lansing, Harrison County, Texas, one of several Pipeline storage facilities. RR 2:30, 72, 169. A storage facility is not part of the interstate pipeline; it is a facility connected to the pipeline. *Id.* Pipeline's storage facilities allow customers such as respondent Peoples to purchase natural gas during the summer (when demand is low and the gas is less expensive) and have it stored until delivery to consumers during the winter (when demand is high and the gas is more expensive). RR 2:32-33, 73, 105-06; 4:48. To put natural gas into the underground storage facility, one must remove it from the pipeline and inject it with compressors. RR 3:13-14.

In conformity with the mandate of the Texas Constitution that "[a]ll real property and tangible personal property in this State . . . shall be taxed in proportion to its value," Tex. Const., Art. VIII, § 1(b), the Texas Tax Code authorizes ad valorem taxation of

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[1] Because this case was tried in Texas, the record appears in two distinct formats. The Reporter's Record (cited as "RR [volume]:[page]") consists of the transcript of the trial court proceedings and trial exhibits. The Clerk's Record (cited as "CR [volume]:[page]") consists of the pleadings, orders, and other documents filed in the case. "PX" stands for "Plaintiff's Exhibit."

real and tangible personal property in the State. Tex. Tax Code § 11.01(a). Section 11.01(a) does not discriminate between goods in intrastate and interstate commerce, but applies generally to all non-exempt goods that the State has jurisdiction to tax. *Id.*

Pursuant to § 11.01(a), Pipeline pays ad valorem taxes to local taxing authorities on its so-called *cushion gas* in North Lansing. RR 2:29-30, 174; 4:17. Cushion gas must remain in the storage facility to provide the necessary pressure so that *working gas* may be delivered to the pipeline. *Id.* Working gas is the balance of the gas in the storage facility that is ultimately removed from storage for transport and delivery to consumers. *Id.*

Pipeline never takes title to working gas while that gas is in the pipeline system. RR 2:175. Pipeline's customers (including Peoples) own the volumes of working gas on the system. RR 2:174; 4:27. If a storage customer "nominates" a volume of gas to be delivered out of its storage account, Pipeline delivers it pursuant to contract. RR 2:175.

For tax years 2003-2005, petitioner Harrison Central Appraisal District included on the tax rolls Peoples' allocable share (as well as the allocable shares of other owners) of the working gas balance of the natural gas stored at North Lansing. RR 3:28, 154-55, 159; PX 1, 4, 7. The allocation was based on Pipeline's records. RR 3:155. Those records included invoices showing the quantity of gas that Peoples had

in storage with Pipeline, systemwide, during the years in question. RR 2:104.

B. Proceedings Below

Peoples protested the Appraisal District's assessments of its working gas. PX 2, 5, 8. After a bench trial, a state trial court entered a judgment that the Appraisal District has the authority to assess the working gas. App., *infra*, 44-45, 46.

The Texas Sixth District Court of Appeals reversed that judgment. App., *infra,* 23. The court rejected Peoples' argument that it did not own the volumes of gas allocated to it for tax purposes. *Id.*, at 5-9. But the court accepted Peoples' argument that the Commerce Clause shields Peoples' gas from state taxation. *Id.*, at 10-22.

One month later, the Supreme Court of Oklahoma issued a contrary decision on materially indistinguishable facts and stated that it was "unpersuaded by [the Texas] court's reasoning." *Missouri Gas,* 234 P.3d, at 959 n.84.

The Supreme Court of Texas denied discretionary review of the decision below. That denial presents this Court with a direct conflict on an important, recurring question of constitutional law between a reviewable decision, which the highest court of Texas has declined to disturb, and a decision of the highest court of Oklahoma.

REASONS FOR GRANTING THE PETITION

This Court should grant the petition to resolve the conflicting responses of Texas and Oklahoma courts to the same constitutional question. The Texas court below held that the Commerce Clause *prohibits* state ad valorem taxation of natural gas in storage on an interstate pipeline system. App., *infra*, 22. The Supreme Court of Oklahoma held that the Commerce Clause *permits* such a tax. *Missouri Gas*, 234 P.3d, at 959 n.84. That conflict means that natural gas on an interstate pipeline system is taxable by state authorities if it is in storage in Oklahoma, but not if it is in storage in neighboring Texas.

The Texas and Oklahoma courts reached those conflicting results because they employed differing constitutional analyses. They did so because, in the context of state ad valorem taxation of goods in interstate commerce, it remains unclear whether or to what extent the four-pronged test this Court adopted in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977), is affected by other, older aspects of this Court's Commerce Clause jurisprudence.

"The Commerce Clause is an express grant of power to Congress to 'regulate Commerce . . . among the several States.'" *United States v. Int'l Bus. Machines Corp.*, 517 U.S. 843, 852 n.2 (1996) (citing U.S. Const., Art. I, § 8, cl. 3). "It does not expressly prohibit the States from doing anything. . . ." *Id.* Yet this Court has long held that "the Commerce Clause is more than an affirmative grant of power; it has a

negative sweep as well." *Quill Corp. v. North Dakota*, 504 U.S. 298, 309 (1992) (citing *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 231-32, 239 (1824) (Johnson, J., concurring)). This so-called "negative" or "dormant" Commerce Clause, *id.*, "limits the power of the States to erect barriers against interstate trade." *Lewis v. BT Inv. Managers, Inc.*, 447 U.S. 27, 35 (1980).

This Court's interpretation of the dormant Commerce Clause "has evolved substantially over the years, particularly as that Clause concerns limitations on state taxation powers." *Quill*, 504 U.S., at 309. In 1977, the Court issued its watershed decision in *Complete Auto*, 430 U.S., at 274. The Court noted that in prior cases it had already "rejected the proposition that interstate commerce is immune from state taxation." *Id.*, at 288. Because "'[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business,'" *id.*, at 279 (quoting *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254 (1938)), the Court adopted a new, four-pronged test for state taxes on those engaged in interstate commerce. A state tax survives a Commerce Clause challenge if it "[1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." *Id.*

Although that four-pronged test has provided a greater measure of predictability to modern dormant

Commerce Clause analysis, unanswered questions remain. First, as the Solicitor General observed, there remains a question regarding the continuing applicability of the Court's "continuity of transit" cases such as *Minnesota v. Blasius*, 290 U.S. 1, 9-12 (1933):

> This Court has not yet decided whether or to what extent *Complete Auto* displaces the older line of "continuity of transit" cases in the specific context of state ad valorem taxes on goods temporarily held in storage during the course of interstate transport.

Br. for U.S. (No. 08-1458) at 10. Second, there remains a question as to whether a "physical-presence" rule, which the Court has held remains applicable in analyzing Commerce Clause challenges to state *sales* and *use* taxation, *Quill*, 504 U.S., at 312-14, likewise applies to ad valorem *property* taxation.

The Supreme Court of Oklahoma in *Missouri Gas* held that both aspects of this Court's older cases were inapplicable. The Texas court below, by contrast, held that they were crucial to the analysis. Those courts' conflicting interpretations of this Court's jurisprudence resulted in their conflicting answers to the same constitutional question.

This Court should grant the petition because, as demonstrated below, the narrow constitutional question presented and the two broader constitutional controversies out of which that question arises are of immense practical and jurisprudential importance, and they are recurring. Moreover, the

decision below is erroneous. The Solicitor General so concluded when she determined that the Oklahoma court, not the Texas court, correctly resolved the constitutional issue presented. *See* Br. for U.S. (No. 08-1458), at 9. This Court should reach the same result here.

I. The Constitutional Question Presented is Important to State Taxing Authorities and Industry Participants Alike.

A. Whether Natural Gas in Storage on an Interstate Pipeline is Immune from State Taxation is Important and Recurring.

The narrow constitutional question presented in this case is the same as the question presented in *Missouri Gas*: whether the dormant Commerce Clause prohibits a State from imposing a generally applicable, nondiscriminatory ad valorem tax on natural gas stored in the State but connected to an interstate pipeline system for out-of-state transport. That this question is important is evident from this Court's invitation to the Solicitor General in *Missouri Gas* to express the views of the United States on the question. *See* Br. for U.S. (No. 08-1458), at 1. That the Solicitor General ultimately concluded that the Supreme Court of Oklahoma reached the right result for the right reasons underscores why the conflicting decision by the Texas court in this case should be reversed.

Not only is the constitutionality of subjecting natural gas in storage to state property taxation important to this Court's dormant Commerce Clause jurisprudence, but the Court's answer will have enormous practical consequences. According to the American Petroleum Institute, natural gas is a $385 billion industry in this country.[2] FERC-regulated interstate natural gas pipelines move nearly a quarter of the nation's energy long distances to markets in the 48 contiguous states.[3] Storage of natural gas on the interstate pipeline system is an important and integral feature of the system. At the close of 2007, 400 underground natural gas storage sites were operational in the United States.[4]

Storage affords great benefit to shippers. It allows them to practice price arbitrage by purchasing natural gas during the summer (when demand is low and the gas is less expensive) and having it stored until delivery to consumers during the winter (when demand is high and the gas is more expensive). RR 2:32-33, 73, 105-06; 4:48.

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[2] Am. Petroleum Inst., *Natural Gas Is America's New Frontier* 1 (2010), http://www.api.org/aboutoilgas/NATGAS_111610.pdf.

[3] Fed. Energy Regulatory Comm'n, *An Interstate Natural Gas Facility on My Land? What Do I Need to Know?* 2 (2010), http://ferc.gov/for-citizens/citizen-guides/citz-guide-gas.pdf.

[4] U.S. Energy Information Admin., Independent Statistics and Analysis, About U.S. Natural Gas Pipelines, Underground Natural Gas Storage, Underground Storage by U.S. Region, http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/undrgrnd_storage.html (last visited Dec. 27, 2010).

The sheer volumes involved are tremendous. The single pipeline company involved in this case has approximately 250 *billion* cubic feet of storage available systemwide. RR 2:163. Thus, whether natural gas in storage on an interstate pipeline system is subject to state property taxation (as the Supreme Court of Oklahoma held and the Solicitor General agreed), or is constitutionally immune from such taxation (as the Texas court held), is of considerable practical importance both to industry participants (which can at least pass along costs to their ratepayers) and to cash-strapped state and local governments.

The recurring nature of this constitutional issue is evident from its coming before this Court twice within a short period of time – first in *Missouri Gas* and then in this case. The nature of the conflicting decisions virtually ensures that the issue will further recur. Any State that has a natural gas storage facility will be encouraged by the Oklahoma decision to tax the working gas stored in that facility. Any taxpayer that faces such taxation will be encouraged by the Texas decision to contest the tax. No state court will be confident as to which analysis is correct unless and until this Court addresses it.

Industry participants have recognized that the issue is recurring and should be addressed by this Court. In its amicus brief to this Court in the *Missouri Gas* case, the American Gas Association stated: "The *ad valorem* taxation of natural gas in FERC-regulated storage within the interstate transportation system presents a recurring issue that merits this Court's attention." AGA Amicus Br. (No.

08-1458), at 3. Because all agree that this constitutional issue is important and recurring, the Court should grant the petition to resolve the conflicting decisions.

B. The Broader – and Also Recurring – Constitutional Questions Make this Case Even More Important.

The substantial importance of the narrow constitutional question presented is amplified by the constitutional controversies out of which that question arises: (1) whether or to what extent this Court's "continuity of transit" analysis applies to modern dormant Commerce Clause analysis after *Complete Auto*; and (2) whether the "physical-presence" requirement, which the Court reaffirmed in *Quill* as to *sales* and *use* taxation, likewise applies to ad valorem *property* taxation. The Court's answers to those questions will affect a far broader range of goods than natural gas.

1. The "Continuity of Transit" Issue is Important and Recurring.

As the Solicitor General explained in *Missouri Gas*, there are "two different lines of dormant Commerce Clause precedents." Br. for U.S. (No. 08-1458), at 9. "In its earlier cases, dating back to the late nineteenth century, this Court applied a 'continuity of transit' analysis to determine whether goods being transported through a State could be subjected to state property taxes." *Id.* "Under that approach, the critical question was whether the interstate transit of

goods had been sufficiently interrupted for purposes other than merely facilitating the transit; if so, the goods were deemed locally taxable." *Id.*, at 9-10.

"In *Complete Auto* this Court announced a new general framework for resolving dormant Commerce Clause challenges to state taxes." *Id.*, at 10. "The Court held that a state tax will be sustained against a dormant Commerce Clause challenge if it [satisfies the Court's four-pronged test]." *Id.* "The Court also overruled its prior holdings that any tax on the 'privilege of doing [interstate] business' was unconstitutional per se." *Id.* (citing *Complete Auto*, 430 U.S., at 288-89). "As compared to the Court's prior 'continuity of transit' decisions, the *Complete Auto* framework requires a more comprehensive inquiry, consistent with the Court's rejection of the per se rule against state taxation of interstate commerce." *Id.*

The Texas court of appeals in this case focused heavily on this Court's "continuity of transit" line of authorities, citing a whole string of pre-*Complete Auto* decisions.[5] Based on those authorities, the court concluded that "[t]he crucial question in determining whether the state may exert its taxing power is

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[5] *See* App., *infra*, 11-14, 17 (citing *Coe v. Errol*, 116 U.S. 517, 527 (1886); *Hughes Bros. Timber Co. v. Minnesota*, 272 U.S. 469, 476 (1926); *Indep. Warehouses v. Scheele*, 331 U.S. 70, 73 (1947); *Carson Petroleum Co. v. Vial*, 279 U.S. 95, 101 (1929); *Blasius*, 290 U.S., at 9-10; *Champlain Realty Co. v. Town of Brattleboro*, 260 U.S. 366, 377 (1922); and *Mich.-Wis. Pipe Line Co. v. Calvert*, 347 U.S. 157, 166-68 (1954)).

whether there is 'continuity of transit.'" App., *infra*, 13. The Texas court then concluded that "[t]he natural gas allocated to Peoples is in the stream of interstate commerce, and this storage does not remove it from interstate commerce." *Id.*, at 17.

Having made the threshold determination that the gas allocated to Peoples was in "continuity of transit," the court, in its ensuing *Complete Auto* analysis, attached little significance to the fact that large volumes of the gas were continuously present in Harrison County, Texas. The court also found it compelling that Pipeline, not Peoples, decided where the gas was to be stored. App., *infra*, 19-20. Under that analysis, the court held the connection between the State of Texas and Peoples' large inventories of storage gas in Texas to be "too tenuous to subject Peoples to ad valorem taxation in Texas." *Id.*, at 20.

In direct conflict with that approach, the Supreme Court of Oklahoma rejected the Texas court's reliance on the "traditional continuity of transit analysis" because it was "superseded by the Supreme Court's decision in *Complete Auto Transit v. Brady*." *Missouri Gas*, 234 P.3d, at 959 n.84. The Court also rejected as immaterial to the *Complete Auto* analysis the factor that the Texas court found to be compelling – that Pipeline, not Peoples, was "the decision maker with respect to the place of storage. . . ." *Id.*

As noted above, the Solicitor General observed that this Court has yet to decide whether or to what extent the "continuity of transit" analysis retains

vitality in Commerce Clause analysis. Br. for U.S. (No. 08-1458), at 10. The Supreme Court of Oklahoma noted the same dearth of authority: "While the [U.S. Supreme] Court has applied the [*Complete Auto*] test to many kinds of taxes, it has never addressed whether the [*Complete Auto*] test applies to an ad valorem tax on goods in the process of being transported in interstate commerce." *Missouri Gas*, 234 P.3d, at 953 (citing *Complete Auto*, 430 U.S. at 279).

A leading tax commentator has likewise noted this lack of clarity. Although "[s]ome of the results of the doctrinal changes" brought about by this Court in recent years "are clear," "the impact of the contemporary Commerce Clause philosophy on other cases decided in earlier eras, and the doctrine they spawned, is less clear." 1 J. Hellerstein & W. Hellerstein, State Taxation ¶ 4.13[1] (3d ed. 2010).

The continuing uncertainty about the role, if any, of "continuity of transit" implicates the full range of goods that taxpayers might argue are in the course of interstate transport. A recent example is a decision holding that oil in a tank farm is immune from state property taxation. *See Midland Cent. Appraisal Dist. v. BP Am. Production Co.*, 282 S.W.3d 215, 224 (Tex. App. – Eastland 2010, pet. denied). Relying on this Court's pre-*Complete Auto* jurisprudence, and citing the decision below, the *Midland Central* court held that because the oil was "in transit in the stream of interstate commerce," state property taxation of the oil was prohibited by the Commerce Clause. *Id.* A petition for a writ of certiorari is likewise being filed

in the *Midland Central* case today. The simultaneous pendency before this Court of these cases illustrates that not only is the "continuity of transit" issue recurring, but it implicates a far broader range of goods than natural gas. Industry, States, and local governments would all benefit from clarification.

2. The "Physical-Presence" Issue is Important and Recurring.

The Texas court concluded that the tax at issue violated the Commerce Clause because it did not satisfy the first prong of *Complete Auto* – "substantial nexus." App., *infra*, 21. Again, having concluded that the gas was in "continuity of transit" in interstate commerce, the court attached little significance to the large amounts of Peoples' gas that were continuously present in Harrison County, Texas. Rather than focus on the presence of the *gas* in storage in Harrison County – the object of the state ad valorem property tax – the court focused instead on the presence of the *taxpayer*: "Peoples maintains no office in Texas. Nor does it have any employees, representatives, or physical facilities in the State." *Id.*, at 19. Because the taxpayer was absent from the State, the Texas court found no substantial nexus. *Id.*, at 21.

In support of its *taxpayer*-focused (not *property*-focused) analysis, the Texas court invoked *Quill*'s "physical-presence" rule: "The Commerce Clause requirement of a substantial nexus with the taxing state is satisfied by the taxpayer's physical presence

in the state." App., *infra*, 19 (citing *Quill*, 504 U.S., at 312-14). *Quill* involved a sales and use tax – not a property tax. In *Quill*, this Court invoked *stare decisis* in declining to renounce the "physical-presence" rule in cases involving Commerce Clause challenges to sales and use taxation. 504 U.S., at 317-18. The Court thereby let stand a bright-line rule that the Court originally adopted a decade before *Complete Auto* in *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 758 (1967).

Again, the Supreme Court of Oklahoma was "unpersuaded by [the Texas] court's reasoning." *Missouri Gas*, 234 P.3d, at 959 n.84. The Oklahoma court rejected the notion that the taxpayer's *in personam* contacts with the State should control for an ad valorem tax on *property*. *Id.* Rather, the Oklahoma court concluded that the fundamental question should be whether the taxpayer *owns property* in the jurisdiction that seeks to impose the ad valorem tax: "While this case certainly presents some complexity, the fundamental question is simple: does the taxpayer own property located in the county seeking to impose the ad valorem tax?" *Id.* "Nothing in the Texas appellate court's decision persuades us that the answer to the correctly formulated question is anything other than a resounding yes." *Id.*

The relevance of the taxpayer's physical presence in the State outside the context of sales and use taxation needs to be clarified. *See Quill*, 504 U.S., at 312-14. One can envision an entire range of situations in which the taxpayer itself might not have an *in*

personam type of "physical presence" in the State, yet could nonetheless own real or personal property in the State that would otherwise be subject to ad valorem taxation. If (as the Texas court held but the Oklahoma court disagreed) such property is beyond the reach of state taxation simply because the taxpayer itself "maintains no office[,] employees, representatives, or physical facilities in the State" (App., *infra*, 19), the adverse impact on state taxing authorities could be incalculable.

The scope of *Quill*'s "physical-presence" requirement is a recurring issue on which state courts are divided. *See Lanco, Inc. v. Dir., Div. of Taxation*, 908 A.2d 176, 177 (N.J. 2006) ("Since the Court decided *Quill*, a split of authority has developed regarding whether the Supreme Court's ['physical-presence'] holding was limited to sales and use taxes. . . . We believe that the better interpretation of *Quill* is the one adopted by those states that limit the Supreme Court's holding to sales and use taxes."), *cert. denied*, 551 U.S. 1131 (2007). Another petition now pending before this Court raises this issue with regard to a state income tax. *See Asworth, LLC v. Dep't of Revenue, Finance, and Admin. Cabinet*, No. 10-662. The present case presents this recurring issue in a narrower, but no less important, context: whether the "physical-presence" rule precludes state taxation where the taxpayer has *property* in the State, and that property is itself the object of the ad valorem tax at issue.

C. This Case Warrants Immediate Review.

This case cleanly presents both the narrow constitutional issue and the two broader constitutional controversies out of which it arises. The competing views of the law have already been analyzed by the Solicitor General as well as the lower courts. Further delay would neither frame the constitutional issue more cleanly nor enhance presentation of the competing arguments. Rather, the delay would only result in continuing confusion, when all concerned desire certainty. This is why even industry opponents of the tax at issue agree with state taxing authorities that this is "a recurring issue that merits this Court's attention." AGA Amicus Brief (No. 08-1458), at 3.

II. The Decision Below is Erroneous.

Three errors in the court of appeals' analysis particularly deserve this Court's attention.

A. The Court of Appeals Erred in Using this Court's "Continuity of Transit" Analysis to Eclipse the *Complete Auto* Analysis.

The Texas court of appeals erroneously concluded that this Court's traditional "continuity of transit" analysis remains "crucial" to the Commerce Clause inquiry. App., *infra*, 13. As the Supreme Court of Oklahoma correctly concluded, that analysis has effectively been "superseded by the Supreme Court's

decision in *Complete Auto*." *Missouri Gas*, 234 P.3d, at 959 n.84.

Examples of this Court's cases employing the older "continuity of transit" analysis include *Blasius*, 290 U.S., at 9-12, and *Bacon v. Illinois*, 227 U.S. 504, 511-17 (1913). The Solicitor General explained the analysis employed in those cases: "Under that approach, the critical question was whether the interstate transit of goods had been sufficiently interrupted for purposes other than merely facilitating the transit; if so, the goods were deemed locally taxable." Br. for U.S. (No. 08-1458), at 9-10. Correspondingly, if the goods were determined to be "in transit in interstate commerce," they were deemed immune from state taxation. *See Blasius*, 290 U.S., at 9. Thus, under the traditional approach, "the 'crucial question' . . . is . . . 'continuity of transit.'" *Id.* (quoting *Carson Petroleum Co. v. Vial*, 279 U.S. 95, 101 (1929)). The question was "crucial" in that bygone era because it was determinative of the State's taxing power.

In contrast, after *Complete Auto*, deciding whether goods are *in* or *out* of the stream of interstate commerce – the objective of the "continuity of transit" test – is no longer determinative. In *Complete Auto*, this Court "rejected the notion that state taxes levied on interstate commerce are *per se* invalid." *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981) (citing *Complete Auto*, 430 U.S., at 288-89). Correspondingly, it is no longer true that determining goods to be *out* of the stream of interstate commerce necessarily means that they are locally

taxable. Rather, this Court has "long since rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to a 'local' or intrastate activity." *Id.*

In short, although the "continuity of transit" analysis was once determinative of the Commerce Clause inquiry, it no longer is. What is determinative today is whether the state tax satisfies the *Complete Auto* four-pronged test. If it does, "no impermissible burden on interstate commerce will be found." *Japan Line, Ltd. v. Los Angeles County*, 441 U.S. 434, 444-45 (1979). Thus, *Complete Auto* has effectively displaced the "continuity of transit" analysis, and the court below erred in granting the latter preeminence.

B. The Court of Appeals Erred in Applying *Quill*'s "Physical-Presence" Rule to Ad Valorem Property Taxation.

Having concluded that Peoples' gas was in "continuity of transit" in interstate commerce, the court of appeals attached little significance to the massive presence of Peoples' storage gas in Harrison County, Texas. Instead, the court supported its conclusion that the Commerce Clause prohibits the state tax at issue by noting that the taxpayer, Peoples, has no office, employees, representatives, or physical facilities in the State. App., *infra*, 19.

Yet the absence of such *in personam* contacts with the State is irrelevant when the tax at issue is

one on *property*. For a property tax, the constant physical presence of an inventory of the property in the State should be sufficient to satisfy the requisite link between the State and the property sought to be taxed. *See Allied-Signal, Inc. v. Dir., Div. of Taxation*, 504 U.S. 768, 777 (1992) (reciting as a "fundamental requirement of both the Due Process and Commerce Clauses that there be 'some definite link, some minimum connection, between a *state* and the . . . *property* . . . it seeks to tax'") (emphasis added) (quoting *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954)). The requisite connection between the *State* and the *property* in this case is substantial.

In holding otherwise, the Texas court of appeals erroneously invoked this Court's decision in *Quill*. App., *infra*, 19 (citing *Quill*, 504 U.S., at 312-14). In *Quill*, the Court declined to overrule the requirement that the taxpayer be physically present in the State to justify imposing a *sales* or *use* tax.

Quill is explicitly narrow, and should be confined to sales and use taxes. *Quill* makes clear that the "physical-presence requirement" originally adopted in *Bellas Hess* was "established for sales and use taxes," and that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement. . . ." 504 U.S., at 314. Alternatively, if this Court concludes that the "physical-presence" rule does apply outside the context of sales and use taxation, the Court should hold that the physical presence of the taxpayer's property in the State suffices to satisfy the rule, at least if that property is the object

of the ad valorem tax at issue. In either event, the Court should hold that the "physical-presence" requirement does not prohibit the ad valorem tax in this case.

C. The Court of Appeals Erroneously Held that the State Tax at Issue Fails the *Complete Auto* Test.

The court of appeals held that the state tax at issue fails the first and fourth prongs of the *Complete Auto* test. App., *infra*, 22. The court was wrong; the tax satisfies both of those prongs.[6]

1. The Tax is on Property that Has a "Substantial Nexus" with Texas.

The first prong of *Complete Auto* requires that the tax be "applied to an activity with a substantial nexus with the taxing State." 430 U.S., at 279. This Court has stated that it is a requirement of both the Due Process Clause and the Commerce Clause that there be some definite link, some minimum connection between a *state* and the *property* it seeks to tax. *Allied-Signal*, 504 U.S., at 777. *Property* – a large inventory of natural gas owned by Peoples and held in underground storage in Harrison County, Texas –

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[6] The tax satisfies the second and third prongs as well. But because the court of appeals did not address those two prongs in its opinion, the Appraisal District does not address them in this petition.

is what the Appraisal District seeks to tax here. Although volumes of Peoples' gas may come and volumes of gas may go, on any given day Peoples has in storage in Texas what can only be described as a massive inventory of natural gas. There is "substantial nexus" between that storage gas and the State of Texas, which suffices for the ad valorem tax at issue to survive constitutional scrutiny.

Professor Hellerstein agrees, concluding with specific regard to this case: "The physical presence of a 'significant volume' of the owner's property appears to be more than sufficient to constitute 'substantial nexus.'" Hellerstein & Hellerstein, *supra*, ¶ 4.13[3][a]. He found the court of appeals' holding to the contrary to be "highly questionable, if not plain error." *Id.*

The Solicitor General similarly concluded that "the nexus between Oklahoma and the 'large volumes of gas' stored there 'for a substantial part of the year' is sufficient to satisfy prong one of the *Complete Auto* test." Br. for U.S. (No. 08-1458), at 21. Exactly the same thing can be said of the large volumes of gas stored in Texas.

A property's mere physical presence in the State may not always suffice to establish "substantial nexus." The Solicitor General provided an example of an exception in *Missouri Gas*: "[T]he transportation of natural gas could be significantly burdened if multiple States attempted to tax the same volume of gas based solely on its movement through an interstate pipeline." Br. for U.S. (No. 08-1458), at 19. In light of this concern, the Supreme Court of Oklahoma limited

its holding to *storage* gas: "[C]oncluding that the natural gas at issue bore a constitutionally sufficient nexus to the taxing State, the Oklahoma Supreme Court carefully limited its holding to *stored* natural gas." *Id.*, at 19 n.6 (emphasis in original) (quoting *Missouri Gas*, 234 P.3d, at 954 (concluding that "[petitioner's] storage gas cannot be characterized as goods that are merely passing through the state")). A similarly limited holding in this case would not open the door to State taxation of commodities in pipelines.

2. The Tax is "Fairly Related to the Services Provided by the State."

The fourth prong merely requires that the tax be "fairly related to the services provided by the State." *Complete Auto*, 430 U.S., at 279. "The simple but controlling question is whether the state has given anything for which it can ask return." *Commonwealth Edison*, 453 U.S., at 625 (internal quotation marks omitted).

Consistent with these authorities, the Oklahoma Supreme Court correctly addressed the fourth prong in a manner applicable here:

> The tax in this case operates on the presence of personal property in Woods County. It is taxed to the same extent as all other personal property in the county. [Taxpayer] MGE is therefore being asked to shoulder no more than its fair share for the support of government-provided services and the receipt of "the advantages of a civilized society."

Missouri Gas, 234 P.3d, at 959 (quoting *Exxon Corp. v. Wisconsin Dep't of Revenue,* 447 U.S. 207, 228 (1980), quoting *Japan Line*, 441 U.S., at 445).

In contrast, the Texas court of appeals incorrectly focused on Pipeline's facility and cushion gas – not Peoples' working gas:

> While we do not doubt the value of [the] services [provided within the county], we note, again, that services such as law enforcement and the fire department would serve the North Lansing facility itself, and the facility undoubtedly belongs to Pipeline, which does pay ad valorem taxes on both the "cushion" gas it maintains in the facility and the physical plant of the facility itself.

App., *infra*, 21-22.

That Pipeline pays ad valorem taxes on its "cushion" gas and "the physical plant of the facility itself" in no way suggests that Peoples' *working* gas should be constitutionally excused from taxation. Peoples benefits from the storage of its working gas in Harrison County, and it should be no less responsible for ad valorem taxation of its working gas than Pipeline is for taxation of its cushion gas. Because Peoples substantially benefits from the storage of its gas, it "may be required to contribute to the cost of providing *all* governmental services, including those services from which it arguably receives no direct 'benefit.'" *Commonwealth Edison*, 453 U.S., at 628 n.16 (emphasis in original).

That Pipeline's "physical plant of the facility itself" is taxed (App., *infra*, 22) is immaterial. The need for fire protection, for example, arises not from the physical plant itself so much as it does from the billions of cubic feet of natural gas stored within the facility.

As with the first prong, Professor Hellerstein concluded that the court of appeals' decision regarding the fourth prong is "highly questionable, if not plain error." Hellerstein & Hellerstein, *supra*, ¶ 4.13[3][a]. He sees "no basis for the conclusion that the taxpayer's gas does not receive 'police and fire protection . . . and the advantages of a civilized society.'" *Id.* This Court should reach the same conclusion.

CONCLUSION

The Court should grant the petition for writ of certiorari.

Respectfully submitted,

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[SEAL]

In The
Court of Appeals
Sixth Appellate District of Texas at Texarkana

No. 06-07-00103-CV

THE PEOPLES GAS, LIGHT,
AND COKE COMPANY, Appellant

V.

HARRISON CENTRAL
APPRAISAL DISTRICT, Appellee

On Appeal from the 71st Judicial District Court
Harrison County, Texas
Trial Court No. 05-0381

Before Morriss, C.J., Carter and Moseley, JJ.
Opinion by Chief Justice Morriss

OPINION

The large amount of natural gas ordinarily stored under Harrison County has great value. The Harrison Central Appraisal District (the District) has acted to assess a large ad valorem tax bill against a portion of that gas—gas allocable to the account of Peoples Gas, Light, and Coke Company (Peoples). From a judgment favoring the District, Peoples appeals.

The gas in question is stored in a large, depleted natural gas field now used as a natural gas storage facility—the North Lansing facility—part of the interstate pipeline system operated by Natural Gas Pipeline Company of America (Pipeline). Peoples is a distribution company that purchases natural gas from suppliers and delivers it to users in Chicago, Illinois. Pipeline, not a party to this matter, operates the interstate pipeline system pursuant to regulations promulgated by the Federal Energy Regulatory Commission (the Commission). Peoples buys natural gas already on the interstate pipeline system owned and operated by Pipeline. Pipeline representatives testifying at trial emphasize that there are many storage facilities associated with its pipeline and that the pipeline is operated "in the aggregate." In other words, Pipeline's storing and transporting gas does not use any particular storage field exclusively.

Pipeline pays ad valorem taxes on what is called "cushion gas" in North Lansing, the significant volume of natural gas that remains in the storage facility and provides the necessary pressure and balance to facilitate the safe, efficient operation of the pipeline. Beginning in 1999, the District allocated to Peoples a portion of the "working" natural gas balance—the volume of gas (above the "cushion") that is transported and delivered to pipeline customers—and assessed taxes on the value of that portion of the natural gas stored at North Lansing. Peoples successfully challenged the assessment and, on advice of its appraisal

consultant firm, the District removed Peoples from the tax rolls. The same thing happened in 2000.

For tax years 2003-2005, the District again attempted to assess taxes against Peoples on a portion of the gas stored at North Lansing. This time, on advice from a new consultant firm, the District refused to remove Peoples from the tax rolls. Instead, the District assessed Peoples' portion of the gas at North Lansing, for those years, at values exceeding nine million, forty million, and forty-three million dollars, respectively. Those tax years and tax levies are at issue in this case.

The gas volume figures allocable to Peoples are based on Pipeline's records.[1] Pipeline compares the total contractual balance for all the NSS[2] shippers that have contracts on Pipeline's Gulf Coast Leg to the "working" natural gas balance at North Lansing at the end of the year. This yields a percentage that is multiplied by each shipper's NSS contractual balance on the Gulf Coast Leg of the pipeline at the end of the

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[1]Pipeline's representative explained that its allocation methods were not for the purpose of determining ownership. It merely did what it was asked to do for the courts to decide the issue of ownership.

[2]Pursuant to Commission tariffs, Pipeline offers several types of contracts to shippers on its pipeline system. Most common are the "NSS" and "DSS" contracts. NSS storage requires a customer such as Peoples to request or nominate a withdrawal to get delivery on a date certain. DSS storage service, on the other hand, allows for no-notice delivery.

year to arrive at the allocation it attributes to a customer.

The trial court ruled that the District has the authority to assess the ad valorem taxes for the years in question on the gas it allocated to Peoples. We review de novo the trial court's conclusions of law determining each question of law independently. *Quick v. City of Austin,* 7 S.W.3d 109, 116 (Tex. 1999). We review the trial court's findings of fact for legal and factual sufficiency, as we do with jury findings. *See Ashcroft v. Lookadoo,* 952 S.W.2d 907, 910 (Tex. App.—Dallas 1997, pet. denied).

Our analysis leads us, through the following logical steps, to conclude that taxing this gas infringes the Commerce Clause:

(1) Peoples owns this gas for ad valorem tax purposes.

(2) The Commerce Clause shields this gas from ad valorem taxation.

  (A) This gas is in interstate commerce.

  (B) This storage does not remove this gas from interstate commerce.

  (C) The District cannot tax this gas.

For these reasons, we reverse the judgment of the trial court and render judgment that assessing these ad valorem property taxes for these years was improper.

(1) Peoples Owns this Gas for Ad Valorem Tax Purposes

The District and Peoples agree that, under the Commission's regulations, Pipeline does not own the gas in its pipeline system. Peoples contends that it does not own, for ad valorem tax purposes, any amount of the massive volume of natural gas lying beneath Harrison County; the District responds that someone must own the gas, and, since Pipeline certainly does not, Peoples *must* be the taxable owner of the portion of the gas allocable to its account.

"Property taxes are the personal obligation of the person who owns or acquires the property on January 1 of the year for which the tax is imposed." TEX. TAX CODE ANN. § 32.07(a) (Vernon 2008). The Texas Tax Code does not define "own" or "owner" for purposes of assessing ad valorem taxes. Texas courts have generally defined taxable "owner" as the individual or entity holding legal title to the property or holding an equitable right to obtain legal title. *See Childress County v. State,* 127 Tex. 343, 92 S.W.2d 1011, 1015 (1936); *Travis Cent. Appraisal Dist. v. Signature Flight Support Corp.,* 140 S.W.3d 833, 840 (Tex. App.—Austin 2004, no pet.); *Comerica Acceptance Corp. v. Dallas Cent. Appraisal Dist.,* 52 S.W.3d 495, 497 (Tex. App.—Dallas 2001, pet. denied). If an individual or entity does not hold perfect legal title, however, that individual or entity may still be considered the taxable owner of property "if he is the record owner, or is vested with the apparent legal title, or is in possession thereof, coupled with such claims and evidences

of ownership as will justify the assumption that he is the owner thereof." *Childress County,* 92 S.W.2d at 1015; *Signature Flight Support Corp.,* 140 S.W.3d at 840. The term "owner" has no fixed legal meaning:

> The meaning of the term owner is not the same under all circumstances. It is not a technical term or word at all, but one of wide application in various connections. In all instances its meaning must be ascertained from the context and subject matter.

Realty Trust Co. v. Craddock, 131 Tex. 88, 112 S.W.2d 440, 443 (1938); *see Signature Flight Support Corp.,* 140 S.W.3d at 839. That said, we examine the "context and subject matter" here to determine whether Peoples owns the gas in question.

We begin with a short explanation of the highly regulated natural gas transportation and storage system and the dealings between Pipeline and its customers, including Peoples. The Commission restructured the natural gas transport and storage industry in 1992. This restructuring created a system of commercial rights for the pipeline customer that was separate from the physical operation of the pipeline system. Buyers and sellers conduct transactions at commercial points—"paper points" or imaginary points—along the pipeline at which a purchase may be completed, points that do not necessarily reflect the physical location of the gas purchased. Pursuant to this restructuring and to facilitate purchase transactions, Pipeline established geographical zones, such as the South Texas zone, the "TEX-OK"

zone, and the Iowa-Illinois zone, which help identify the distance the gas is transported from the point at which it was injected into the pipeline system.

Applying the *Comerica/Travis County* test, we conclude Peoples is the owner for ad valorem taxation purposes. As the parties agree, Pipeline has complete control of the physical operation of the pipeline system. Pipeline decides where and when the natural gas is stored. There is no physical connection between a Pipeline customer's storage account balance and physical volumes at any particular storage facility. The District acknowledges that Pipeline's accounting methods are completely divorced from the physical reality of the natural gas location. Pipeline's customers purchase volumes of natural gas at what the parties refer to as a "paper" pooling point after which time, Peoples emphasizes, the purchaser retains no control to direct the physical movement of the natural gas purchased. Peoples also emphasizes that Pipeline's storage fields are operated on an aggregated basis. That is, none of its services are specifically linked to any particular storage field.

Relevant documents show that Peoples purchased natural gas and paid for its transportation to the Iowa-Illinois zone. Of course, the fungible and ethereal nature of natural gas makes it impossible to ascertain the physical location of a given allocated portion of natural gas at any moment. Peoples contends that this documentary evidence in the form of Commission-approved agreements between Peoples and Pipeline suggests that Peoples' allocation of

natural gas is "contractually" located in the Iowa-Illinois zone. Obviously, Pipeline cannot identify particular volumes of gas as belonging to a particular customer when physically transporting or storing natural gas.

Consistent with Commission regulations, Pipeline is in full custody, control, and possession of the natural gas within the pipeline system. Only Pipeline can direct the physical movement of the gas once it is placed in the pipeline; and, even after a purchase of gas at a paper pooling point, the purchaser obtains no control over the physical movement of the volume of natural gas purchased. Peoples has no legal right to the natural gas located at North Lansing; it cannot specifically request gas from that facility and could not merely back a truck up to the facility and remove any amount of natural gas. Nor is there any indication that it could do any such thing in Illinois. Peoples emphasizes that it owns merely contractual rights to physically receive natural gas in Chicago and that its purchases from Pipeline call for contractual storage in the Iowa-Illinois zone.

Nonetheless, by regulation, ownership rights could not be transferred to Pipeline. That said, according to the District, legal title must lie with Peoples. No doubt gas is stored beneath Harrison County; there must be an owner of that gas for tax purposes. Considering the nature of the product at issue here, the nature of the pipeline in which customers' fungible goods must be commingled, and the highly regulated industry in which Pipeline and

Peoples conduct their business and which prohibits Pipeline from having ownership rights in the gas but requires that it maintain physical control of the natural gas, we conclude the trial court correctly decided that, for tax purposes, Peoples owns an allocation of the natural gas stored in Harrison County.[3]

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[3]Last year, the Kansas Supreme Court decided a case similar to the instant case. *See In the Matter of the Appeal of the Director of Prop. Valuation,* 284 Kan. 592, 161 P.3d 755 (2007). In that case, several non-Kansas entities (municipal utilities, natural gas marketing company, and public utilities) had contracted for gas storage or deferred delivery with an interstate pipeline that maintained storage facilities in Kansas. *Id.* The parties stipulated that none of the entities had facilities within Kansas or sold, traded, or delivered natural gas anywhere in Kansas. *Id.* at 594. In Kansas, a public utility's property is not exempt from ad valorem taxes. The taxing entity argued that non-Kansas companies were public utilities within the following definition: "that own, control, and hold for resale stored natural gas in an underground formation in this state." *Id.* at 597. Based on the legal and contractual relationship between the pipeline and its customers established by Commission-approved tariffs, the Kansas Supreme Court concluded the entities were not public utilities because they did not "control" and "hold for resale" the stored natural gas. *Id.* at 606. With that, the non-Kansas companies' allocations were exempt from ad valorem taxes. It did, however, touch on the ownership aspect of the "public utility" definition:

> There is no serious dispute that the Taxpayers own (or at least hold contractual rights to) storage balances of natural gas contained in underground formations in the state. Nevertheless, whether the Taxpayers actually control and hold the natural gas is doubtful. It is undisputed that tariffs issued by the . . . Commission . . . establish that control and possession

(Continued on following page)

(2) The Commerce Clause Shields this Gas from Ad Valorem Taxation

Peoples argues that, even if it could be said that it is the taxable owner in this matter, the Commerce Clause shields it from the District's assessment since the natural gas is in interstate commerce and since the tax cannot pass the test that would permit the District to assess such a tax on this property. We agree.

The Commerce Clause grants Congress the power to regulate interstate commerce. U.S. CONST. art. I, § 8, cl. 3. Congress protects interstate business activity by restricting state regulation of interstate commerce.[4] *See Marathon Ashland Petroleum, L.L.C. v. Galveston Cent. Appraisal Dist.*, 236 S.W.3d 335, 337-38 (Tex. App.—Houston [1st Dist.] 2007, no pet.).

> of natural gas delivered to interstate pipelines for transportation and storage is vested in the pipelines until the gas is redelivered to their customers. It is also undisputed that the interstate pipelines cannot track and account for discrete packages or molecules of natural gas delivered for storage. As the Supreme Court said in *Central Illinois*, under federal regulations the pipeline customers have "little or no control over where the severed natural gas is stored or for how long."

Id. at 603. Our conclusion on the ownership issue is consistent with the Kansas Supreme Court's conclusion.

[4]Congress has granted the Commission exclusive jurisdiction to regulate the natural gas industry through the Natural Gas Act (NGA). *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988).

(a) This Gas Is in Interstate Commerce

Traditionally, the United States Supreme Court has identified three ways in which goods can enter the stream of interstate commerce: (1) the goods have been shipped, (2) the goods have been placed with a common carrier, or (3) the goods have started a continuous route or journey into interstate commerce. *See Coe v. Errol,* 116 U.S. 517, 527 (1886); *Marathon Ashland Petroleum, L.L.C.,* 236 S.W.3d at 338. The goods become a part of interstate commerce when their movement demonstrates that the goods have started and are bound for another state. *See Hughes Bros. Timber Co. v. Minnesota,* 272 U.S. 469, 476 (1926). Goods are not a part of interstate commerce when the record shows only preparation or intent to send those goods out of state. *See id.*; *Marathon Ashland Petroleum, L.L.C.,* 236 S.W.3d at 340-41.

Here, it is apparent that the natural gas has been placed with a common carrier, Pipeline. Unlike the taxpayer in *Marathon Ashland Petroleum, L.L.C.,* Peoples does not maintain any control over the physical movement of the gas. Moreover, that common carrier is an interstate pipeline specifically governed by the Commission. There is little dispute that the natural gas in the *pipeline* is in interstate commerce. A critical question is whether the gas in North Lansing storage is similarly in interstate commerce.

(b) This Storage Does Not Remove this Gas from Interstate Commerce

The District takes the position that, although an extremely small portion of the natural gas (that portion actually moving in the pipeline) is actually in interstate commerce, the rest of the natural gas is stored and therefore subject to local taxation wherever it is located. More specifically, the District argues that the fact that the portion of natural gas allocated to Peoples here is not actually moving in the pipeline and is, rather, stored beneath Harrison County takes the gas outside interstate commerce, leaving it subject to taxation as a part of the mass of property within the State of Texas. *See Coe,* 116 U.S at 527; *Marathon Ashland Petroleum, L.L.C.,* 236 S.W.3d at 338.

We conclude this contention fails in the face of two areas of the law: authorities determining the effect of transportation stoppage on whether a product is in interstate commerce and authorities more specifically addressing storage of natural gas.

First, we look to the line of cases examining generally the circumstances surrounding the stoppage of products that have been injected into the stream of interstate commerce and determining whether a stoppage in a jurisdiction would subject the goods to local taxation. *See Indep. Warehouses, Inc. v. Scheele,* 331 U.S. 70, 73 (1947); *see also Virginia Indonesia Co.*

v. Harris County Appraisal Dist., 910 S.W.2d 905, 912-13 (Tex. 1995).[5] When there is a break in the interstate transit, the property may come to rest within a state and become subject to the power of the state to impose a nondiscriminatory property tax. *Indep. Warehouses, Inc.*, 331 at 72-73. The crucial question in determining whether the state may exert its taxing power is whether there is "continuity of transit." *Id.* at 73 (citing *Carson Petroleum Co. v. Vial*, 279 U.S. 95, 101 (1929)). The United States Supreme Court explained the concept:

> If the interstate movement has begun, it may be regarded as continuing, so as to maintain the immunity of the property from state taxation, despite temporary interruptions due to the necessities of the journey or for the purpose of safety and convenience in the course of the movement. . . . Formalities, such as the forms of billing, and mere changes in the method of transportation do not affect the continuity of the transit. The question is always one of substance, and in each case it is necessary to consider the particular occasion or purpose of the interruption during which the tax is sought to be levied. . . .

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[5]In *Virginia Indonesia Company*, the Texas Supreme Court determined whether the Import-Export Clause would permit imposition of an ad valorem tax. Similar considerations are involved when determining the "continuity of transit" for purposes of the Commerce Clause. *See* 910 S.W.2d at 912.

Id. (quoting *Minnesota v. Blasius,* 290 U.S. 1, 9-10 (1933)). We must look at the facts of each case and will consider the owner's intention, the owner's ability to change destination, the agency or method of transportation, the actual continuity of the journey, and the purpose of the interruption. *See Champlain Realty Co. v. Town of Battleboro,* 260 U.S. 366, 377 (1922).

The character of the shipment in such a case depends on the circumstances, including what the owner has done to prepare for the journey and to carry it out. *Virginia Indonesia Co.,* 910 S.W.2d at 912-13. For instance, when the stoppage of property in interstate commerce is necessary for the safety and convenience of the goods, we do not consider the continuity of transit broken. *Indep. Warehouses, Inc.,* 331 U.S. at 73. On the other hand, if the stoppage is attributable to the business purpose of the owner, then we deem the continuity of transit terminated and the goods are subject to tax in the jurisdiction of the stoppage. *Virginia Indonesia Co.,* 910 S.W.2d at 912. Put another way,

> [w]here property has come to rest within a State, being held there at the pleasure of the owner, for disposal or use, so that he may dispose of it either within the State, or for shipment elsewhere, as his interest dictates, it is deemed to be a part of the general mass of property within the State and is thus subject to its taxing power.

Indep. Warehouses, Inc., 331 U.S. at 73.

In the instant case, the record shows and the law requires that Peoples has no control over the physical operations of the pipeline. Control lies solely with Pipeline. Since Peoples has no control over where that natural gas is stored and how much is stored at any given location, we cannot say that Peoples made the decision to store gas at North Lansing in order to serve its business purpose. Simply put, it made no decision at all regarding the physical location of the stored natural gas.

The District contends Peoples benefits from the storage at North Lansing since it can buy gas at a cheaper rate in the summer months and store it for later use in the winter months when the demand in the Chicago area increases dramatically. It may well be the case that the advent of a pipeline system that will allow for storage of a significant amount of natural gas is beneficial to local distributing companies generally. Indeed, such a system would seem to be beneficial to all. Such a benefit, however, does not alter the fact that Peoples, while benefitting from a storage system generally, makes no decision to store the natural gas at North Lansing specifically. The record shows that the contracts between Peoples and Pipeline do not specify that the gas would be located in Texas. In fact, those agreements provide for "contractual" storage in Iowa and Illinois. The truth is, Pipeline operates its system without regard to the physical reality of identifying a specific storage facility at which any customer's volume of natural gas will be physically stored. Rather, Pipeline operates

the pipeline on an "aggregate" basis in which all the storage facilities serve the pipeline as needed to operate efficiently and effectively. With these facts in mind, we conclude that the stoppage of natural gas in North Lansing does not serve the business purpose of Peoples. To the contrary, Peoples has no control over where the natural gas is stored, and we cannot say that the stoppage in Harrison County serves a business purpose as contemplated by the cases dealing with the continuity of transit of goods in interstate commerce.

Second, we examine law specifically concerning the storage of natural gas. Commission regulations provide some guidance as to whether storage would take the natural gas out of the stream of interstate commerce: "Transportation includes storage, exchange, backhaul, displacement, or other methods of transportation." 18 C.F.R. § 284.1(a). By regulation, then, at least some storage is considered a part of the transportation process. Therefore, storage can be a part of *interstate* transportation. Storage in North Lansing, then, as a matter of regulatory definition, would not necessarily take the natural gas out of the stream of interstate commerce.

Indeed, the United States Supreme Court has spoken on this issue:

> Petitioners argued below that Storage was not a natural gas company within the meaning of the NGA, contending that the storage of gas constitutes neither the transportation nor the sale of gas in interstate commerce.

> Both courts below rejected this argument . . . reasoning that "transportation" includes storage. "Underground gas storage facilities are a necessary and integral part of the operation of piping gas from the area of production to the area of consumption."

Schneidewind, 485 U.S. at 295 n.1 (quoting *Columbia Gas Transmission Corp. v. Exclusive Gas Storage Easement,* 776 F.2d 125, 129 (6th Cir. 1985)); *see also Michigan-Wisconsin Pipe Line Co. v. Calvert,* 347 U.S. 157, 166-68 (1954) (evaluating Texas tax on "gathering" gas in context of interstate pipeline, characterizing situation and "so closely related to interstate transportation as to be practically a part of it," and concluding that the tax in that situation violated Commerce Clause). This storage of this natural gas in North Lansing does not take the gas out of interstate commerce. To conclude otherwise would be to segregate, from the pipeline itself, a function deemed "necessary and integral" to the pipeline. We will not do so and, instead, conclude that this storage does not take this natural gas out of the stream of interstate commerce it entered by injection into an interstate pipeline. The natural gas allocated to Peoples is in the stream of interstate commerce, and this storage does not remove it from interstate commerce.

(c) The District Cannot Tax this Gas

It remains possible that the District could still have the authority to tax the portion of natural gas allocated to Peoples, despite the fact that the natural

gas has been injected into and remains within the stream of interstate commerce. A state tax does not violate the Commerce Clause if it (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state. *See Vinmar v. Harris County Appraisal Dist.*, 947 S.W.2d 554, 555 (Tex. 1997) (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)); *Diamond Shamrock Ref. and Mktg. Co. v. Nueces County Appraisal. Dist.*, 876 S.W.2d 298 (Tex. 1994); *Rylander v. 3 Beall Bros. 3, Inc.*, 2 S.W.3d 562, 570 (Tex. App.—Austin 1999, pet. denied). If a tax does not satisfy this test, called the *Complete Auto* test, the Commerce Clause prohibits the tax. *See Harris County Appraisal Dist. v. Transamerica Container Leasing, Inc.*, 920 S.W.2d 678, 682 (Tex. App.—Houston [1st Dist.] 1995, writ denied). The second and third parts of the *Complete Auto* analysis, which require fair apportionment and nondiscrimination, prohibit taxes that pass an unfair share of the tax burden onto interstate commerce. *Quill Corp. v. N.D.*, 504 U.S. 298, 313 (1992). The first and fourth prongs, which require a substantial nexus and a relationship between the tax and state-provided services, limit the reach of state taxing authority so as to ensure that state taxation does not unduly burden interstate commerce. *Id.*

The Commerce Clause requires "some definite link, some minimum connection,[6] between a state and the person, property, or transaction it seeks to tax." *Allied-Signal, Inc. v. Director, Division of Tax,* 504 U.S. 768, 777 (1992) (quoting *Miller Bros. v. Maryland,* 347 U.S. 340, 344-45 (1954)); *3 Beall Bros. 3, Inc.,* 2 S.W.3d at 570. The Commerce Clause requirement of a substantial nexus with the taxing state is satisfied by the taxpayer's physical presence in the state. *3 Beall Bros. 3, Inc.,* 2 S.W.3d at 570; *Lawrence Indus., Inc. v. Sharp,* 890 S.W.2d 886, 892-93 (Tex. App.—Austin 1994, writ denied); *see also Quill Corp.,* 504 U.S. at 312-14.

The record demonstrates that Peoples maintains no office in Texas. Nor does it have any employees, representatives, or physical facilities in the State. The physical facilities in Harrison County belong to Pipeline, as does the decision to use the North Lansing facility. Further, there is no evidence that any of the natural gas Peoples has purchased is delivered to any customer in Texas.

If we were to look strictly at the generic act of storing gas in a reservoir in Harrison County, it

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[6]The "substantial nexus" requirement is not, like due process' "minimum contacts" requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. *Quill Corp.,* 504 U.S. at 313. Accordingly, an entity may have the "minimum contacts" with a taxing state as required by the Due Process Clause, and yet lack the "substantial nexus" with that state as required by the Commerce Clause. *Id.*

might appear that such an activity would have a substantial nexus with the State. We note again that, as required by the Commission regulations, Pipeline—not Peoples—directs that activity, and we are to consider not whether Pipeline's activities have a substantial nexus with the State, but whether Peoples' activities do. Peoples engages in the purchase and delivery of natural gas to its customers in Chicago. Its only connection in this respect to Texas is through the structure and location of Pipeline's pipeline and Pipeline's decision to store a significant amount of natural gas in North Lansing. Such a connection is too tenuous to subject Peoples to ad valorem taxation in Texas.[7]

The District contends the nexus lies between the natural gas and the State. The natural gas, it argues, comes from Texas and is, thus, substantially connected to the State such that the State should be allowed to tax it. The record suggests that much of the gas is Texas-produced. Nevertheless, we do not have specific

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[7]We also note our sister court's opinion in *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. App.—Austin 2000, pet. denied). In *Bandag Licensing Corp.*, the Austin court suggests that "when the corporation conducts its activity solely through interstate commerce and lacks any physical presence in the state, no sufficient nexus exists to permit the state to assess tax." *Id.* at 300. That connection, along with the facts that the corporation's only activity was the "passive possession of a license to do business in Texas" and that the corporation had no physical presence in Texas, led the court to conclude that the Commerce Clause prohibited the imposition of a state tax in that situation.

volumes of that production, nor could we ever know the location from which Peoples' allocation originated.

We conclude that, despite the fact that Peoples owns some of the natural gas on the system and thus under Harrison County, the storage of natural gas at the North Lansing field is an insufficient nexus when we consider the particular, unique circumstances at hand and the complex relationships among the parties involved. We find insufficient nexus between Texas and the entity, property, or transaction to be taxed. That said, the District's tax fails to satisfy the first prong of the *Complete Auto* test and, therefore, violates the Commerce Clause.

Moving to other parts of the test, we look at the relation between Peoples and services provided in Harrison County. Under the Commerce Clause, the measure of the tax must be reasonably related to the extent of the taxpayer's presence or activities within the taxing state and to the taxpayer's consequent enjoyment of the opportunities which the state has afforded. *3 Beall Bros. 3, Inc.,* 2 S.W.3d at 571. Even though fire and police services may not be invoked, protection conferred by these "along with the usual and usually forgotten advantages conferred by the state's maintenance of a civilized society are justifications enough for the imposition of a tax." *See Transamerica Container,* 920 S.W.2d at 683. The District presented substantial evidence of services provided within the county. While we do not doubt the value of those services, we note, again, that services such as law enforcement and the fire department

would serve the North Lansing facility itself, and the facility undoubtedly belongs to Pipeline, which does pay ad valorem taxes on both the "cushion" gas it maintains in the facility and the physical plant of the facility itself.

Having found that the District's tax on Peoples' gas fails to meet, at least, the first and fourth prongs of the *Complete Auto* test, we conclude that assessment of ad valorem taxes, on these facts, runs afoul of the Commerce Clause.

We reverse the trial court's judgment and render judgment that assessing these ad valorem property taxes for these years is improper.

Josh R. Morriss, III
Chief Justice

Date Submitted: June 18, 2008
Date Decided: September 24, 2008

[SEAL]

Court of Appeals
Sixth Appellate District of Texas

JUDGMENT

The Peoples Gas, Light and Coke Company, Appellant		Appeal from the 71st Judicial District Court of Harrison County, Texas (Tr. Ct. No. 05-0381). Opinion delivered by Chief Justice Morriss, Justice Carter and Justice Moseley participating.
No. 06-07-00103-CV	V.	
Harrison Central Appraisal District, Appellee		

BE IT REMEMBERED, that in accordance with the Court's opinion of this date, the Court finds that there was error in the judgment below. Therefore, it is **ORDERED** that the judgment of the court below is **REVERSED** and judgment is **RENDERED** that the natural gas in the North Lansing facility, allocable to Peoples Gas, Light, and Coke Company is not subject to the ad valorem taxes assessed by Harrison Central Appraisal District for tax years 2003-2005.

It is further **ORDERED** that the appellee, Harrison Central Appraisal District, pay all costs incurred by reason of this appeal.

RENDERED SEPTEMBER 24, 2008
BY ORDER OF THE COURT
JOSH R. MORRISS, III
CHIEF JUSTICE

ATTEST:
Debra Autrey, Clerk

NO. 05-038 1

THE PEOPLE'S GAS LIGHT AND COKE COMPANY,	§	IN THE DISTRICT COURT OF
v.	§	HARRISON COUNTY, TEXAS
HARRISON CENTRAL APPRAISAL DISTRICT,	§	71st JUDICIAL DISTRICT

FINDINGS OF FACT
AND CONCLUSIONS OF LAW

Identification of the Parties

1. Plaintiff is Peoples Gas Light and Coke Company ("Peoples Gas"), a corporation duly formed, organized and existing under the laws of the State of Illinois, with the principal office located at 130 East Randolph Drive, 24th Floor, and Chicago, Illinois and serving retail customers in the Chicago, Illinois area with natural gas.

2. Defendant is Harrison Central Appraisal District ("HCAD"), which is duly organized and acting pursuant to the laws of the State of Texas and is located in Harrison County, Texas.

Pre-Suit Procedural History of the Tax Case:

The Court takes judicial notice of the Stipulations 1-21 and Finds those matters to be Facts as set out in Plaintiff's Proposed Findings of Fact #3-21; and in

the interest of brevity will not set them out again herein.

Peoples Gas and its Business

3. Peoples Gas is a local distribution company responsible for receiving gas from upstream suppliers and delivering it to small residential, commercial and industrial customers within the City of Chicago proper.

4. Peoples Gas maintains no office or employees in Texas, and owns no property in Texas except its ownership of gas it has purchased and is stored in the North Lansing storage facility of NGPL in Harrison County.

5. Peoples Gas contracts with Natural Gas Pipeline of America ("NGPL",) an interstate open access transportation and storage pipeline, for the storage and transportation of natural gas it purchases.

NGPL and its System:

6. NGPL is an interstate pipeline transporting and storing natural gas. Its business of interstate transportation of gas is regulated by FERC. The entire NGPL system will accommodate approximately 250 bcf of gas. But of that amount only a small amount, no more than about 10 to 12 bcf, is located in the pipeline itself. The remainder is located in storage facilities.

7. The NGPL pipeline system in question in this suit consists of two major legs and a "bridge" pipeline

between the two legs. The system forms an inverted "A." The Gulf Coast Leg or Amarillo Leg extends from the southern part of Texas, along the Gulf Coast, through Harrison County, and on through Arkansas, Missouri, and Illinois to the City of Chicago. The Amarillo leg extends from southeastern New Mexico and west Texas through the Texas panhandle, Oklahoma, Kansas, Nebraska, Iowa, and Illinois to the City of Chicago. The "AG line" connects the two pipelines and runs through portions of Oklahoma and Texas.

8. The primary flow of the system is from the southern regions of the United States northward to Chicago. However, along the Louisiana line, from the Texok branch of that line near Houston into Louisiana, gas primarily flows from west to east and in the last several years has flowed exclusively west to east.

9. Gas on the Louisiana leg of the Gulf Coast Line flows primarily east from its intersection with the Gulf Coast Line toward Louisiana, where it may be transferred from the NGPL system to another common carrier for transportation. Under ordinary operating conditions, gas from the Louisiana leg does not reach the North Lansing storage field and gas from the North Lansing storage field does not reach the Louisiana leg.

10. A large portion of the gas on the NGPL system originates in Texas producing fields though it is true that an NGPL customer delivering gas into NGPL's pipelines in New Mexico, arranging transportation

using rights on the Amarillo leg of NGPL's system, and scheduling delivery in Chicago, may actually receive molecules originating offshore in the Gulf of Mexico and transported on NGPL's Gulf Coast Leg. However, due to the nature of the movements on the NGPL system, gas in the North Lansing storage field is very likely produced from the ground in Texas. There is no evidence to indicate that any non-Texas gas is definitively present in the North Lansing storage facility.

The Role of the North Lansing Storage Facility:

11. NGPL uses storage facilities to support the transportation services and to provide storage services to its customers. With respect to the transportation of gas through the system, NGPL adjusts pressures and flow rates in the system to meet the needs that are coming up over the next few hours or days. In order to function properly, the NGPL pipeline must remain full at all times. The volume in the pipeline at any given time is referred to as "line pack". While line pack may be increased or decreased to some degree, the primary capacity of the NGPL system to increase or decrease inventory is in the storage fields. But pipelines can and are operated without storage facilities. The storage rather than transportation function is of greater importance overall. The amount of line pack as of each valuation date was established and detailed in Defendant Exhibit 17.

12. Gas does not flow into and out of NGPL's storage fields while it is in transit through the pipeline. Rather, to put gas into a storage field, it must be taken out of the pipeline and forced under high pressure into the storage field. The storage field is not a just a pipeline of another size. Any gas that is deposited into the North Lansing storage field comes to rest for a business purpose of the owners as well as for NGPL.

13. Due to the unitary and constantly pressured nature of the NGPL system, an amount of gas that is acquired or injected into the system at any point on the system may be delivered at any other point on the system on the same day. The gas which is delivered is not literally the same gas molecules that were acquired, but instead an equivalent number of decatherms.

14. Peoples Gas as well as other NGPL storage customers take advantage of the NGPL storage services to capture the arbitrage value of gas; to ensure adequate supplies of gas in the peak demand cold months; to reduce the need for transportation capacities of gas from the producing areas of the country to the consuming Chicago market area during the typical heating months; and to capture the year-round constant production of gas in a way that will meet the seasonal demand for gas. Peoples Gas typically acquires gas during the warm months of the year, when gas prices are lower, and puts it into storage with NGPL for withdrawal during the cold months of the year when gas prices are higher. Gas

stored to meet seasonal demands of Peoples' customers in a depleted gas reservoir field like the North Lansing facility can be accumulated for as long as the storage customer needs to store its gas with NGPL.

15. In the NGPL system, there are several such storage facilities. These are not manmade but natural underground porous rack formations. Besides the Lansing facility, NGPL owns another depleted gas reservoir storage field located in Sayre, Oklahoma. NGPL also owns several aquifer storage fields, located in the Iowa and Illinois area. Aquifer storage fields are less useful than depleted gas reservoir fields for storing gas because the gas must be cycled in and out of the aquifer storage fields within a few months in order to avoid dissipation of the gas and mixing of the gas with water. An aquifer storage field cannot be used to hold gas for more than a few months at a time. On the other hand, gas can be stored in a depleted gas reservoir, such as the North Lansing storage field, indefinitely without significant risk of dissipation of gas.

16. The North Lansing storage field in Harrison County, Texas is connected to the Gulf Coast Line. It holds approximately 70 billion cubic feet (bcf) of cushion gas. *Cushion gas* is the volume of gas continuously held in the storage field which is necessary to keep the storage field pressurized for delivery. It is not routinely withdrawn from the field unless the reservoir is to be abandoned or retired. The cushion gas is owned by NGPL. The field also contains approximately 83 bcf of working gas. Working gas is the

volume held in the storage field or in the pipeline which is being stored or moved, respectively, on behalf of various customers of NGPL. *Working gas* is not physically separated from cushion gas; the two are commingled in the storage field. The working gas on the NGPL system belongs to the multiple storage customers (or, in some cases, transportation customers) of the NGPL system.

17. The North Lansing Storage Field in Harrison County is the largest capacity storage field on the NGPL system. It is filled nearly to capacity by November 1 of any given year, and the working gas is significantly depleted by April 1 of the following year. The storage capacity of the North Lansing field represents approximately one-third of the entire storage capacity of the NGPL system and more than half of the storage capacity of the Gulf Coast leg.

18. Due to the nature of movements on the NGPL system, gas in the North Lansing storage field is very likely produced from the ground in Texas. There is no evidence to indicate that any non-Texas gas is definitively present in the North Lansing storage field.

The North Lansing Facility and FERC

19. The North Lansing facility is a jurisdictional field regulated by FERC. FERC asserts jurisdiction when they find that the facility is in interstate commerce.

20. The North Lansing facility is a component of the NGPL System, located in the Tex-Ok receipt and delivery zones.

22. NGPL pays property tax on the North Lansing facility's cushion gas, surface facilities, compression treating facilities, wells and gathering systems.

23. In 2002, NGPL applied with FERC for a certificate of public convenience and necessity authorizing NGPL to construct and operate facilities at its North Lansing storage field; FERC made findings that the NGPL proposed construction was in the public interest because it would convert cushion gas into working gas so that NGPL could provide increased storage service on its system; that the proposed facilities, which would provide increased storage service on the NGPL system, would be used to transport gas in interstate commerce; and the proposed facility could appropriately be described as used to transport gas in interstate commerce.

The Business on "Paper":

24. In the NGPL system, the physical molecules of gas themselves come into the system at various points, predominantly in the southern production regions of Texas but also offshore and in New Mexico and then primarily flow northward. The physical location of the gas used to satisfy a customer's demands has no relation to where that customer's gas may be contractually located. NGPL operates its system on a unitary basis: it can supply gas to a customer from any point it chooses to do so.

25. To facilitate the business of buying and transporting, selling and paying, rather than the physical end of transporting physical molecules of gas, the NGPL system is divided into paper storage points and paper pooling points which are designated by unique numbers. Buyers and sellers of gas may trade in gas contractually at paper pooling points and may store gas contractually with NGPL at paper storage points.

26. Paper pooling points and paper storage points do not literally contain the amounts of gas traded or stored at those points. They are an accounting device only and are designated at certain locations in order to facilitate commerce on the NGPL system and to allow NGPL to calculate charges to its customers for transportation and storage services. The paper pooling points or paper storage points where gas is shown to be on NGPL's accounting records bear no relationship to where NGPL chooses to physically store the gas.

27. Each month, NGPL sends each of its customers, including People's Gas, an invoice which details the movements of gas on the NGPL system in the previous month, as well as the stored volumes of gas of that customer. Stored volumes are listed according to their designated contractual paper storage points. The volumes located at the storage points per the invoices do not indicate that *physical* volumes were literally located in the physical area corresponding to the paper storage point.

28. NGPL offers multiple types of storage contracts. The two primary types of storage contracts are DSS (Delivered Firm Storage Service) and NSS (Nominated Firm Storage Service).

29. Delivered [Firm] Storage Service (DSS) is available only in the market area; that is, the area near Chicago, inclusive of the states of Illinois and Iowa. DSS has a transportation component included with it. Gas is available in the market area from a DSS account on demand without any notice from NGPL's customer. DSS accounts are listed contractually as being located in the Iowa-Illinois zone.

30. Nominated Firm Storage Service (NSS) is a storage service which requires the owner to nominate a volume of gas it wishes to have delivered from its storage account with NGPL. Normally, NGPL requires that a nomination be made one day in advance of the customer's desired delivery date. It is available contractually at any paper storage point on the NGPL system.

31. Storing gas under a DSS account is initially considerably more expensive than storing gas under a NSS account. However, if a customer stores gas under a NSS account, it may later have to pay transportation to move the gas to the point where it wishes to take delivery.

32. NGPL does not keep physically separate any of the physical volumes of the gas owned by any of its customers. Customers deposit gas in the NGPL system or acquire gas in the NGPL system and trade

or take delivery of that gas based on a heating unit equivalent known as a decatherm (equal to one million Btu's). Gas from one NGPL location is mixed with other gas in similar locations on the system.

33. The amount of gas that can be delivered out by a storage facility in any given period of time is determined by how full that storage field is. The more full the storage field, the greater the volume of gas it can deliver out. At peak capacity, the North Lansing storage field can deliver one bcf of gas per day.

34. There is no physical storage facility on the NGPL system in the South Texas zone, the Louisiana zone, the Gulf Coast main line zone, the Permian zone, or the Amarillo main line.

35. The North Lansing storage field is proximate to the Texok zone. However, neither North Lansing nor any other storage facility has any contractual connection to the Texok zone or any other zone to- which it may be proximate.

36. Gas shown on NGPL's accounting records to be in a paper storage point in one zone is often physically located in a physical storage field that is not proximate to that zone.

37. Storage customers do not contract for storage in any particular storage field and do not tell NGPL to put gas into any particular storage field. Instead, they contract to have gas in paper storage points in particular zones.

38. Transportation agreements between NGPL and its customers are known as [Firm] Transportation Service agreements (FTS).

39. When a customer acquires gas or introduces gas on the NGPL system, it either markets that gas or deposits the gas into a storage account. If the paper storage point is in the same zone in which the gas was acquired or introduced, the customer does not incur transportation charges. If the paper storage point is in another zone, the customer pays a transportation charge under an FTS agreement to theoretically transport gas to the paper storage point.

40. During 2002 through 2005, Peoples Gas paid transportation charges to NGPL to have the gas it acquired transported to either the Iowa-Illinois zone or the Louisiana zone. This meant that NGPL's accounting records showed Peoples' gas to be stored at paper storage points in those zones. Those records, however, did not reflect the actual *physical* presence of any gas.

41. Even though a storage customer may own gas which is contractually located in the Iowa-Illinois zone and wish to take delivery in the Iowa-Illinois zone on the Gulf Coast leg, that storage customer must, nevertheless, have a FTS agreement with NGPL extending to a point near the North Lansing storage field because it is likely that gas will have to be supplied to the Chicago market area from the North Lansing field.

42. There is insufficient storage field capacity on the NGPL system in the states of Iowa and Illinois to accommodate all of the gas stored in DSS and NSS accounts on the NGPL system.

Benefits to Peoples Gas of the North Lansing Storage Facility:

43. NGPL ultimately utilizes gas withdrawn from the North Lansing storage field in order to satisfy customer needs in the Chicago market area.

44. Peoples Gas benefits from having the gas it has contractually purchased and stored in the North Lansing storage field. Multiple storage fields have enhanced delivery capacity over lesser numbers of storage fields, and geographic diversity of storage fields reduces the possibility of widespread disruption in deliverability due to weather or other natural disasters. Even though customers do not select the physical sites for the storage of gas, they benefit from having NGPL store their gas in the North Lansing storage field.

45. At the beginning of the heating season (around November 1 of each year), approximately 95% of NGPL's storage capacity is generally utilized.

46. The northern storage fields experience productivity declines over the course of the heating season (the cold months), as those fields are depleted and cycled out.

47. Throughout the time frame of 2002 through 2005, Peoples Gas has acquired gas in Texas, at Texas

pooling points, and has maintained FTS agreements with receipt points throughout Texas.

48. Notwithstanding the fact that a specific amount is gas [is] not literally moved from one location to another at the behest of a shipper, the transportation customer pays NGPL as if the purchased gas were moved from the point of receipt to the point of delivery.

49. NGPL anticipates a demand of gas by monitoring the weather in the northern area of its system, particularly the Chicago area. When NGPL anticipates a cold front, it immediately begins moving gas to the Chicago area without waiting for nominations for the same.

50. The relationship between NGPL and its customers is governed by the NGPL tariff and by contracts between NGPL and its customers.

51. Many of the contracts, but not all, between NGPL and Peoples Gas specify Texas as the choice of law governing them.

52. The predecessor or parent company of Peoples Gas built the first gas pipeline from Texas to Chicago in the 1930's. That company owned NGPL and its pipeline and storage system up until 1980, when it sold NGPL to Kinder-Morgan, Inc. The North Lansing storage field was developed by NGPL prior to the time People's Gas sold NGPL to [Kinder-Morgan.]

53. The parent company of People's Gas Light and Coke Company is known as Energy. Other subsidiaries of Energy own gas fields and production in Texas[.]

54. One mcf (thousand cubic feet) of gas on the NGPL system is approximately equal to 0.93 decatherms.

55. NGPL has sufficient storage capacity on its Amarillo leg to accommodate the contractual storage for the Amarillo leg.

56. It is unlikely that any gas from the Amarillo leg is actually physically located in the North Lansing storage field.

Allocation and Calculation Methods and Relationship to Harrison County:

57. Beginning in 1999, in response to the needs of some of its customers, NGPL began preparing allocations regarding ownership of gas at the North Lansing storage field and the Sayre storage field in Oklahoma.

58. The calculation for North Lansing was made by first assuming that all DSS gas was located in the northern storage fields since it has to be immediately available in the Chicago market area. The proportion of ownership of NSS gas in the North Lansing field was then determined by a fraction, the numerator of which is the entire amount of working gas in the North Lansing storage field as of the valuation date, and the denominator of which is the entire amount of NSS gas contractually stored on the Gulf Coast leg.

59. The resulting fraction was then multiplied by the NSS contractual balance of each storage customer on the Gulf Coast leg. Each storage customer then

received a letter from NGPL which detailed the allocated ownership of gas at the North Lansing storage field.

60. As owner and operator of the pipeline system, NGPL is in the best position to know where its customers' gas is physically stored on the NGPL system.

61. The Harrison Central Appraisal District adopted the allocation ownership as determined by NGPL and appraised each owner of NSS gas on the Gulf Coast leg, with the resulting figure attributable to that owner.

62. The allocation method prepared by NGPL and adopted by the Harrison Central Appraisal District indicates that People's Gas owned 2,409,869 mcf of gas as of January 1, 2003 at the North Lansing storage field. The Appraisal District valued that gas at $9,350,290.00.

63. The allocation method prepared by NGPL and adopted by the Harrison Central Appraisal District indicates that People's Gas owned 6,997,012 mcf of gas as of January 1, 2004 at the North Lansing storag[e] field. The Appraisal District valued that gas at $40,498,700.00.

64. The allocation method prepared by NGPL and adopted by the Harrison Central Appraisal District indicates that Gas owned 7,580,674 mcf of gas as of January 1, 2005 at the North Lansing storage field. The Appraisal District valued that gas at $43,816,296.00.

65. Peoples Gas does not care where NGPL physically stores the gas it transports. The concern of Peoples Gas is that gas be delivered to it when and where demanded.

66. Peoples Gas is aware that NGPL utilizes the North Lansing storage facility to meet its system needs.

67. There was a constant presence of a substantial quantity of gas in the North Lansing storage field at all times and throughout 2002 through 2005.

68. Peoples Gas has maintained a constant presence of a substantial quantity of gas in the NGPL system in NSS accounts and derivatively, in the North Lansing storage field, throughout 2002 through 2005.

69. Any gas that is deposited into the North Lansing storage field comes to rest for a business purpose of the owners as well as for NGPL.

70. Harrison County provides services that are substantially related to the taxes it imposes on the gas in the North Lansing storage field. Specifically, Harrison County provides public roads, law enforcement services, health services, public records services, courts, incarceration services, traffic control, and fire suppression services.

71. Hallsville Independent School District encompasses the North Lansing storage field. Hallsville ISD provides services which are substantially related to the taxes it imposes on the gas in the North Lansing storage field. Specifically, it provides free public

education to children and youths of school age within the school district.

72. Harrison County Emergency Services District No. 1 encompasses the North Lansing storage field. The district provides services substantially related to the taxes it imposes on the gas in the North Lansing storage field. Specifically, it provides fire suppression and emergency response services throughout the district. Both it and Harrison County have, on occasion, responded to fires and emergencies concerning gas lines and pumping stations related to the North Lansing storage facility.

73. Since the Harrison CAD appraised only that gas which was actually in the North Lansing storage facility as of January 1 of each year in question, there is no need to allocate any value to other states.

74. A null point exists within the Gulf Coast Leg of the NGPL system. The null point is where the direction of flow switches from one direction to another. There is no evidence that the null point drops south of the North Lancing field.

CONCLUSIONS OF LAW

1. This Court has jurisdiction over Plaintiff's claims for tax years 2003, 2004 and 2005.

2. As of January 1, 2003, 2004 and 2005, the Plaintiff owned substantial quantities of gas in the NGPL system.

3. Throughout 2002 through 2005, there was a constant presence of a substantial quantity of gas in the North Lansing storage field.

4. Throughout 2002 through 2005, People's Gas maintained a constant presence of a substantial quantity of gas in the NGPL system and in the North Lansing storage field.

5. The allocation method determined by NGPL and adopted by the Harrison Central Appraisal District for determining the amount of gas owned by each storage customer at the North Lansing storage field is reasonable and compelling. Gas has not shown that any possible alternative allocation method would be more fair or reasonable.

6. Gas owned by People's Gas in the NGPL system and the North Lansing storage field was at all times in question [system] a quantity of tangible personal property subject to taxation in the State of Texas and Harrison County.

7. The gas owned by People's Gas in the NGPL system, and specifically in the North Lansing storage field, as determined by the allocation method described above, had taxable situs in Harrison County, Texas as of January 1, 2003, 2004 and 2005, in the quantities listed above. The gas was in Harrison County on January 1 of each relevant year for more than a temporary period.

8. At all times during 2002 through 2005, the gas in the North Lansing storage field was not and had not been involved in interstate commerce.

9. Any gas in the North Lansing storage field during 2002 through 2005 which might have at some time been moved in interstate commerce had come to rest as of January 1 of each of those years for the business purpose of the owner, and it was not in actual transportation at that date. It was a part of the general mass of property in Harrison County.

10. Gas owned by "Peoples" Gas in the North Lansing storage field as of January 1, 2003, 2004 and 2005 had a substantial nexus with the State of Texas.

11. The ad valorem taxes assessed on the gas owned by People's Gas at the North [Lansing] storage field do not discriminate against interstate commerce.

12. Since the Harrison Central Appraisal District appraised only gas which was actually located in the North Lansing storage field as of January 1, 2003, 2004 and 2005, there is no occasion for allocating any of the value of that gas to other states or counties.

13. The taxes assessed by Harrison County; Hallsville Independent School District, and Harrison County Emergency Services District No. 1 on the gas at the North Lansing storage field are fairly related to the services provided by those several entities.

14. Even if the gas in the North Lansing storage field was moving in interstate commerce, the taxes on

that gas satisfy the test set out in [*Complete Auto*] *Transport v Brady.*

15. The Plaintiff presented no evidence or legal authority in support of, nor did it ultimately preserve its claim for invalidating the tax at issue herein under the supremacy clause of the United States Constitution.

Signed July 24, 2007

/s/ Bonnie L. Hagan
Judge Presiding

CAUSE NO. 05-0381

PEOPLES GAS, LIGHT AND COKE	§	IN THE DISTRICT COURT
VS.	§	HARRISON COUNTY, TEXAS
HARRISON CENTRAL APPRAISAL DISTRICT	§	71ST JUDICIAL DISTRICT

FINAL JUDGMENT

On January 22, 2007, the above styled and numbered cause of action was called for trial. Both parties announced ready for trial and presented evidence and argument to the Court without a jury, none being requested. The Court, having considered the evidence, arguments and law, finds that judgment should be entered for the Defendant.

IT IS, THEREFORE, ORDERED that the Plaintiff take nothing hereby, that the taxable status as determined by the Defendant on the property that is the subject of this litigation remains unchanged. All costs are assessed against the Plaintiff.

This judgment is final and appealable and resolves all claims and parties brought before the Court. All relief not explicitly granted [herein] is denied.

Signed on this the 1st day of June, 2007.

/s/ Bonnie L Hagan
HONORABLE
BONNIE LEGGAT

[SEAL] OFFICIAL NOTICE FROM
SUPREME COURT OF TEXAS
Post Office Box 12248
Austin, Texas 78711-2248

[POSTMARK MAR 12 2010]

RE: Case No. 09-0053
COA # 06-07-00103-CV
STYLE: HARRISON CENTRAL APPRAISAL DISTRICT
v. THE PEOPLES GAS, LIGHT AND COKE COMPANY

Today the Supreme Court of Texas denied the petitions for review in the above-referenced case.

MAIL TO:

MR. DOUGLAS W. ALEXANDER
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515 CONGRESS AVENUE
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AUSTIN TX 78701-3520

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[POSTMARK OCT 01 2010]

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